

July 17, 2002

Mr. Howard M. Spinner
Division of Energy Regulation
Virginia State Corporation Commission
P. O. Box 1197
Richmond, Virginia 23218-1197

Re: Response to Letter Dated June 10, 2002

Dear Mr. Spinner:

This letter is to respond to your letter June 10, 2002 seeking the views of Washington Gas Energy Services, Inc. (WGES) regarding the calculation of projected market prices for generation. The ultimate goal is for the Virginia State Corporation Commission to establish wires charges for customers taking electric service from Competitive Service Providers (CSPs).

It is the view of WGES that the main objective of deregulation in Virginia is the creation of a competitive electricity market where customers can actually take electric service from Competitive Service Providers (CSPs). For this to happen, comparable prices for power should reflect proxy prices at the retail level. The legislation prescribes what should be considered in determining an annual adjustment for "projected market prices for generation." According to the rules:

"...the projected market prices for generation when determined under this subsection (56-583.A), shall be adjusted for any projected market prices for transmission, transmission line losses, and ancillary service...which the incumbent electric utility (i) must incur to sell its generation and (ii) cannot otherwise recover in rates subject to state or federal jurisdiction."

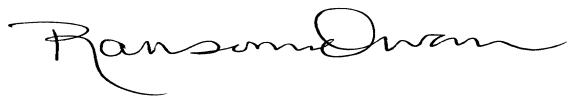
Unfortunately, there has been no showing of **"just and reasonable net stranded cost" that cannot otherwise be recovered in rates** for each utility, as envisioned in subsection 56-584. (emphasis added). The concept of stranded cost recovery is indisputable and sanctioned by both federal and state energy regulators. Therefore, when such prior approved costs are determined as stranded, utilities could then choose to collect net stranded cost either through wires surcharges or capped rates. It should be noted that the need for wires charges is not universal among utilities in the state. For example, Allegheny Power has elected to forego wires charges and would instead collect strand cost through capped rates. Additionally, in certain situations, a voluntary divestiture of utility generation assets could actually result in stranded benefits to ratepayers.

The imposition of a calculated wholesale price-to-compare by its nature creates a retail price gap and a false sense to ratepayers who may erroneously think that the Commission approved wholesale rates would bring them retail competitive offers. Therefore, the continued reliance on the use of artificial wholesale prices as benchmark retail prices for competitive power defeats competition. Any potential upward adjustments to the Commission wholesale calculation price model as a result of this exercise would likely fall short of a reasonable price to beat, an important market signal and stimulus.

Despite the limitations that regulatory restrictions place upon a reasonable retail price-to-compare at this time, recognition should be given to the use of approximate prices paid for wholesale load following services in PJM in order to reduce this wholesale-retail pricing abnormality and market failure. To this end, the Commission could examine a two-year load following PJM strip with added optionalities at the retail level and backout certain non-core ancillary items and private margins. This might increase the wholesale price-to-compare more than the current calculations permit but the results would make prospective meter prices marginally better than the status quo.

WGES understands that the Commission has to comply with the existing rule in section 56-583.A. Regrettably, incremental measures, no matter how well intended, that do not lead to CSP marketing activities and shopping by consumers would fall short of advancing the goal of deregulation. Therefore, credence should be given to the idea of modifying the law through the legislature when the Commission files its 2002 regulatory status report in the coming months.

Sincerely,

A handwritten signature in black ink, reading "Ransome E. Owan". The signature is fluid and cursive, with the first name "Ransome" being more prominent and the last name "Owan" following in a similar style.

Ransome E. Owan
Director, Regulatory & External Affairs

copy: Mr. Harry A. Warren